Separating the stock from the company

To raise the finance for a new line of product, this distributor restructured the company, created a stock holding subsidiary, and arranged trade finance without disturbing the other creditors.

A building materials distributor, with offices in Dublin and London, imports product from Continental Europe and the Middle East, selling on to wholesale merchants and larger builders. It saw an opportunity to expand through a new product line, but to do so needed additional working capital facilities.

The company already had a 10 year term loan on the property, a leasing agreement over 3 to 5 years for the equipment, and managed its working capital through an overdraft facility.

With all available security pledged to the current financiers - the property is mortgaged, the lessors own the equipment and the overdraft financiers have a fixed and floating charge over all the remaining assets - the difficulty was in raising extra finance without security.

'Should a trade finance bank advance funds in this situation, it would be increasing the security of the original financiers whilst being unable to obtain any itself', says David Murray,
which advised on the solution.

To get around the dilemma, the company developed a new structure. As the new finance was required for the new product, imported from the Middle East, this specific trade and its attendant working capital requirements were isolated into a newly incorporated company. This subsidiary was to act as a stock holding company for the new product range.

The subsidiary purchases the materials from its Middle Eastern supplier by way of letter of credit or direct payment drawn on the Trade Finance Bank. The subsidiary would retain title to the materials until sold to the parent company.

The parent company obtains orders from its Irish and UK customers for these materials and arrange their delivery. The subsidiary invoices its parent for each delivery of the materials, and allows the exact credit terms to the parent as the parent is allowing to the final customer. These credit terms are supported by the parent drawing a bill of exchange (60 or 90 days) in favour of the subsidiary. In this way, the subsidiary is paid for the materials at the same time that the parent is paid by the customer.

The trade finance bank involved was happy to accept a fixed and floating charge over all the assets of the subsidiary. This allowed additional working capital to be provided which for the new range of products which did not disturb the existing credit lines or security arrangements of the company.

The trade finance bank retained security over all the stocks for which it was providing the requisite finance, or alternatively was secured on a bill of exchange drawn on the parent company in respect of materials already sold to customers.

In this case the financiers were happy to advance a facility of £500,000 on these terms, and the company was able to introduce a new line of business which otherwise would have been stifled through a lack of working capital.